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TAX REFORM: TRIBAL TAX PARITY

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The Choctaw Nation of Oklahoma appreciates this opportunity to submit comments in connection with the Ways & Means Committee's current focus on Tax Reform through the work of its Charitable/Exempt Organizations Tax Reform Working Group and its Debt, Equity and Capital Tax Reform Working Group.

Indian tribal governments like the Choctaw Nation of Oklahoma have a unique legal status under the U.S. Constitution and numerous federal statutes, court decisions and treaties. Like States, Indian tribes are political bodies with a governmental structure. They have the power and responsibility to enact various laws regulating the conduct and affairs of their citizens and of activities occurring on their lands. Tribes provide a broad range of governmental services to their citizens, including education, transportation, public safety, public utilities, health, economic assistance, natural resource management, elder care and social/cultural programs.

The Choctaw Nation of Oklahoma (the "Nation") is a federally recognized Indian tribe whose lands are now located in a 10.5 county service area in southeastern Oklahoma which is larger than the state of Massachusetts. In keeping with its heritage and traditions/culture, the Nation seeks to be self-sufficient and to provide high-quality governmental programs and services that address the unique socio-health, cultural, natural resource and economic needs of its people. Like many other Indian tribes throughout the United States and unlike most state and local governments, the Nation does not have a significant tax base. Because it cannot depend on either its own tax base or federal government revenues to provide essential services to tribal citizens, the Nation has developed a core of Tribal enterprises to generate revenues.

Federal tax reform is of great interest to our Tribe and its citizens. There are many ways in which the federal tax system is in need of reform. While Indian tribes are generally treated as governments and, as such, their undistributed governmental revenues are not subject to federal income tax, they are frequently treated less favorably than state and local governments under our federal Tax Code and by the Internal Revenue Service. Such federal differential treatment results in Indian tribal

governments being denied certain federal tax exemptions and incentives that state and local governments typically enjoy -- such as full access to tax-exempt financing. In addition, disproportionate IRS audits have resulted in an actual chilling of the bond market for tribal government bond issuances.

Federal tax reform represents a significant opportunity to provide more consistency in the federal Tax Code with respect to governmental entities -- including state, local and tribal governments.

I. The House's Consistent Recognition of the Importance of Tribal Tax Parity

The House of Representatives, and in particular the Ways & Means Committee, has established a consistent track record of working on a bipartisan basis to recognize that Indian tribes should be treated on par with states for federal tax purposes. The Indian Tribal Governmental Tax Status Act was based on legislation introduced in 1981 by Representatives Jones, Conable, Frenzel, and Matsui (H.R. 3760, 97th Cong.). The legislation's goal was to put Indian tribes on par with states for federal tax purposes. While that Act (codified in Section 7871 of the Tax Code) fell short of its original intent in several respects, it represented a significant step toward the goal of governmental tax parity.

Since the early 1980s, the House has consistently recognized the need to put Indian tribes on par with states--particularly, in the areas of federal unemployment tax, tribal tax-exempt financing, tribal pension plans, and tribal charities.

- In 2000, many Representatives, including several current members of the Ways and Means Committee, supported the inclusion in a House-Senate conference of a provision to treat tribes like states for Federal Unemployment Tax Act (FUTA) purposes. See H.R. 5662 (Community Renewal Tax Relief Act of 2000), introduced December 14, 2000 (incorporated by reference into the conference report to H.R. 4577 (the Consolidated Appropriations Act of 2001)). *This legislation was enacted in 2001.*

- In 2001, several members of the House, including current Ways & Means Committee Chairman Dave Camp and Representative Ron Kind, sponsored legislation to permit Indian tribal governments to issue tax-exempt bonds, including private activity bonds, if at least 95 percent of the net proceeds are used to finance tribal facilities. See H.R. 2253 (Tribal Government Tax-Exempt Bond Activity Reform Act of 2001) (introduced on June 20, 2001). *This legislation was not enacted.*

- In 2003 and 2007, many members of the House, including current Ways & Means Committee Chairman Dave Camp and Ways & Means Committee members Representatives Jim McDermott, Charles Rangel, and Xavier Becerra introduced or co-sponsored legislation to treat tribes like states for tax-exempt financing purposes. See H.R. 1421 (Tribal Government Tax-Exempt Bond Fairness Act) (introduced on March 25, 2003) and H.R. 3164 (Tribal Government Tax-Exempt Bond Parity Act) (introduced July 24, 2007). *These bills were not enacted.*

- More recently, in 2011, Representative Tom Cole introduced legislation to give tribes greater access to tax-exempt financing, and to treat tribal pension and employee benefit plans the same as state and local government plans. See H.R. 1599 (Indian

Country Economic Development Act) (introduced April 15, 2011). *This bill was not enacted.*

Notwithstanding this long and consistent history of legislative interest, few of these initiatives have been enacted, and there remain many ways in which tribes still are not treated as states for federal tax purposes.

II. Tribal Tax Parity -- Priority Legislative Issues

A. Tribal Tax-Exempt Financing

The Ways and Means Committee's consideration of tribal tax-exempt financing in the context of tax reform is timely. There has been a need to change the tax law applicable to such bonds for many years, but the current economic climate highlights in even greater relief the harsh realities of the financial market and the steep obstacles faced by tribes in financing many worthwhile projects in Indian Country. Now that the Treasury Department's study has acknowledged that current law is lacking in "tax parity, fairness, flexibility and administrability," it is time for Congress to move forward and adopt new rules for tribal bonds. See Department of Treasury, Report and Recommendations to Congress regarding Tribal Economic Development Bond Provision under Section 7871 of the Internal Revenue Code (December 19, 2011). As detailed above, Representative Camp and other Members have long recognized the need for change in this area, having introduced in 2001, 2003, 2007 and 2011 legislation aimed at leveling the playing field for tax-exempt bonds.

There are several key components to legislation that would effectively level the playing field for tribal tax exempt bonds, including:

- Eliminating the essential governmental function test for tribal governmental bonds

- Avoiding the imposition of unworkable restrictions, such as a territorial limitation on tribal bond financed facilities

- Authorizing the financing of facilities within a tribe's federally-recognized governmental service area, so as to uniformly address the diversity of land status in Indian communities

- Repealing the prohibition on private activity bonds and substituting a workable volume limitation procedure

We firmly believe that the lack of a tribal tax base may justify other measures to remove the barriers to federal guarantees of certain types of tax-exempt debt issued by Indian tribal governments. These political measures will significantly enhance Indian tribes' ability to generate alternative revenue sources to provide for critically needed services to their communities and citizens.

1. Eliminating the Essential Governmental Function Test

Under current law (other than through the special provision for tribal economic development bonds contained in the American Recovery and Reinvestment Act), Indian tribal governments are allowed to issue tax-exempt bonds only to finance facilities that

serve an "essential governmental function." While neither the statute nor any IRS regulation defines what constitutes an "essential governmental function," the legislative history describes the test in terms of activities "customarily performed by State and local governments with general taxing powers." It is frequently very difficult to determine—with the certainty that a tax-exempt debt offering requires--whether particular activities are "customarily performed" by states and municipalities. While it is clear that Indian tribes may finance roads, schools and sewers, the essential governmental function test has become troublesome when applied to many other areas in which state and local governments have become increasingly active – *e.g.*, convention centers, tourist accommodations and public recreational facilities including golf courses, energy production and distribution facilities, parking and transportation—just to name a few. Moreover, because the standard is both fact-specific and open to IRS interpretation, the chances of inequitable and uneven treatment increase dramatically.

By contrast, the standard generally applicable to state and local government bonds (the "state/local government standard") has proven to be a workable one. It is met if either 90 percent or more of bond proceeds are used for governmental use (the "private business use" test), or 90 percent or more of debt service is payable or secured from governmental payments or property (the "private payment" test). While there will undoubtedly be interpretive issues with respect to what constitutes a governmental use, and what constitutes a governmental payment, we believe that these issues will be much easier to work out and apply to the Indian tribal government context than the essential governmental function test. Thus, the state/local government bond standard should be extended to include Indian tribal government bond financings.

In sum, replacing the essential governmental function test with the state/local government standard has at least three advantages: (1) the state/local government standard is more administrable than the essential governmental function test, (2) as a policy matter, Indian tribal governments should not be treated differently than state and local governments, and (3) the private business use test (or, alternatively, the private payment test) will sufficiently ensure that tax-exempt bond proceeds are used appropriately.

2. Avoiding the Imposition of Other Unworkable Restrictions

While the Treasury Department has agreed that the essential governmental function test is unworkable and should be repealed, it continues to recommend that Congress consider enacting some kind of territorial or locational restriction on tribal tax-exempt financing. Like the pilot provision in ARRA limiting the use of Tribal Economic Development Bonds (TEDBs) to projects located on Indian reservations, a tax proposal in the Obama Administration budget for FY 2013 would require that tribal bond-financed projects be located on or near Indian reservations. See Treasury Department, General Explanation of the Administration's Revenue Proposals (released February 2012), p. 51 (http://www.treasury.gov/resource-center/tax-policy/Pages/general_explanation.aspx). Under the Administration's tribal bond proposal, projects located "near" as opposed to "on" a reservation would be required to "provide goods or services to resident populations of Indian reservations." It should be noted that no similar locational

restriction applies to state or local government bonds, while private activity bonds merely need to demonstrate a "nexus" or "substantial connection" to the jurisdiction of the bond issuer.

The territorial limitation in ARRA would, if extended to a broader range of tribal bonds, cause numerous practical problems. Many Indian tribes no longer have much land, particularly land which has been accepted into trust by the United States or land that meets the definition of "reservation". Other tribes may have ample reservation or trust land, but are so remotely located that no revenue-generating facilities can be placed there. The land also may not be in an area where significant community services, such as health care or education, can be rendered to the tribe's citizens as a practical matter. The proposed territorial limitation places these tribes at a serious disadvantage.

In light of these facts, we strongly recommend that any future legislation contain no territorial restriction whatsoever as long as the proceeds are not for private use (*i.e.*, no territorial restriction on tribal government bonds). We also think that a flexible standard should apply to tribally-issued private activity bonds.

If Congress believes a territorial restriction is necessary, it should allow tribes to finance projects that have a "substantial connection" or an appropriate "nexus" to a Tribe's reservation, using a definition for the term "reservation" that is no more restrictive than the one found in Code Section 168(j) (Accelerated Depreciation). The "substantial connection" or "nexus" test is illustrated in Private Letter Ruling 8442023 (July 12, 1984). In this ruling, the IRS permitted an industrial development authority to finance a hotel approximately 10 miles outside its jurisdictional boundaries because the issuer was able to show that there would be a direct, material benefit to the issuing jurisdiction.

3. Repealing the Prohibition on Private Activity Bonds

The revenue proposal contained in the FY 2014 Administration Budget would allow Indian tribal governments to issue tax-exempt private activity bonds for the same types of projects and activities as are allowed for state and local governments under Section 141(e) under a national bond volume cap. In addition, the same volume cap exceptions applicable to state and local governments would apply to the tribal tax-exempt bonds. However, unlike state and local private activity bonds, tribal private activity bonds (like all tribal bonds) would be subject to a territorial or project location restriction and a gambling facility restriction.

As noted above, the Treasury proposal would employ a national bond volume cap for Indian tribal governments, which it describes as comparable to that applicable to states, but also "tailored" to the tribal context. Specifically, Treasury proposes a national tribal bond cap that would be an amount equal to the greater of:

> (i) a total national Indian tribal population-based measure determined under Section 146(d)(1)(A) (applied by using such national Indian tribal population in lieu of State population) *[$190,000,000 based on an assumed Indian tribal population of 2,000,0000 nationwide],* or

(ii) the minimum small population-based State amount under Section 146(d)(1)(B) *[$284,560,000 in 2012]*.[1]

It would also delegate to the Treasury Department the responsibility to allocate this national bond volume cap among Indian tribal governments.

Allocation schemes have not worked well for Indian Country bond financings. For example, Congress provided an allocation scheme for state, local and tribal governments to issue Clean Renewable Energy Bonds (CREBs), but no tribal governments received CREBs allocations. Congress also provided an allocation scheme for TEDBs, and while the national volume cap of $2 billion was fully allocated among over 75 tribes in two tranches, we understand that only 5% of this amount had been issued by the expiration date, and now the remaining 95% must be re-allocated. Many tribes applied for allocations with little or no readiness to issue debt, while others were not able to use their allocation because it was too small and did not cover the cost of the project to be financed.

If tribal private activity bonds are subject to a locational restriction, they should not also be subject to a national volume cap that must be allocated among the over 500 potential tribal government issuers.

B. Tribal pension and employee benefit plans

If the "essential governmental test" is unworkable in the government bond context, it is proving to be even more unworkable in the tribal employer plan arena.

Under a provision negotiated by a House-Senate Conference on the Pension Protection Act of 2006, tribal governmental plans are not treated as "governmental plans" unless all of the employees in the plan are substantially engaged in "essential governmental" functions, and not commercial activities. While the legislative history of the provision suggests that Congress intended to exclude casino, hotel, service station, casino and marina employees from being covered by a governmental plan (if the employer is a tribal government), it did not give much guidance on how the test would apply in other contexts.

Consequently, tribal government employers have been hamstrung in their efforts to maintain governmental plans, and economically coerced to adopt private employer plans. Because of the typical mix of tribal governmental and economic development functions, the 2006 provision is uniquely ill-suited to the needs of tribal government

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[1] According to the US Census website (http://quickfacts.census.gov/qfd/states/00000.html), there are an estimated 2,804,327 self-identifying American Indian/Alaska Native individuals in the US as of 2011. This number reflects people who self-identify as AI/AN, not the number of enrolled members. By contrast, in the BIA's 2005 American Indian Population and Labor Force Report, the latest available, the total number of enrolled members of the (then) 561 federally recognized tribes was shown to be 1,978,099. See http://www.bia.gov/cs/groups/public/documents/text/idc-001719.pdf. Given the 7 years that have passed since that BIA report was issued (including changes in the number of federally recognized tribes), it is unclear whether this number remains accurate.

employers. We also suspect that if this same test was applied to present-day state government workforces, they would find it equally unworkable.

The Senate-passed version of the 2006 pension legislation (S. 1783, 109th Cong.), which had strong bipartisan support from members of this Committee, contained a much more administrable and equitable approach to the treatment of tribal governmental plans. Such language is reproduced below as follows.

> **SEC. 1311. DEFINITION OF GOVERNMENTAL PLAN.**
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> (a) Amendment to Internal Revenue Code of 1986- Section 414(d) of the Internal Revenue Code of 1986 (definition of governmental plan) is amended by adding at the end the following: `The term `governmental plan' includes a plan established or maintained for its employees by an Indian tribal government (as defined in section 7701(a)(40)), a subdivision of an Indian tribal government (determined in accordance with section 7871(d)), an agency instrumentality (or subdivision) of an Indian tribal government, or an entity established under Federal, State, or tribal law which is wholly owned or controlled by any of the foregoing.'.
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> (b) Amendment to Employee Retirement Income Security Act of 1974- Section 3(32) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1002(32)) is amended by adding at the end the following: `The term `governmental plan' includes a plan established or maintained for its employees by an Indian tribal government (as defined in section 7701(a)(40)), a subdivision of an Indian tribal government (determined in accordance with section 7871(d)), an agency instrumentality (or subdivision) of an Indian tribal government, or an entity established under Federal, State, or tribal law that is wholly owned or controlled by any of the foregoing.

Congress should adopt similar language to eliminate the dysfunctional complexity of present law and to put tribal governmental plans on par with state and local plans.

C. Permanent extension of the Indian employment tax credit

The Indian employment tax credit and accelerated depreciation on Indian lands are valuable tools for businesses within the Nation that employ Choctaw citizens and their spouses. A permanent extension of these tax incentives will provide continuity for existing businesses as they employ Choctaws. It will also serve as an effective marketing tool for new business development with our treaty territory. This can only happen if the incentives are extended permanently in the tax code. Last ditch efforts have been common in recent years to extend these incentives. Most recently, they were extended as part of the American and Taxpayer Relief Act of 2012. These last minute extensions, while welcome, are uncertain, and can provide confusion for employers and business owners in Indian Country. Congress should enact a permanent extension to provide certainty in hiring and recruiting business in Indian Country.[2]

[2] See the American Taxpayer Relief Act of 2012, Public Law 112-240, 126 Stat. 2313

Conclusion

We support tax reform efforts to re-fashion the Tax Code so it is simpler and fairer for everyone. Tribal governments have long been subjected to tax laws that are neither simple nor fair. By consistently treating tribal governments like state governments (and eliminating certain special tribal rules we have described above that are so unworkable), tax reform could unlock great economic growth in Indian Country. Congress should exercise greater oversight of the IRS to ensure that its administration of the Tax Code (including through IRS examinations) is equitable and appropriately respectful of tribal governments. Tax reform -- whether achieved through statutory changes or legislative oversight -- can empower Tribal governments to progressively advance their self-governance and self-reliance goals and leave behind their historical dependency on federal appropriations.

For more information about the topics discussed in these comments, please contact:

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